

Message Text

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PAGE 01 STATE 075687
ORIGIN EUR-12

INFO OCT-01 ISO-00 ONY-00 /013 R

DRAFTED BY EUR/WE/EMROWELL
APPROVED BY EUR/WE/EMROWELL
DESIRED DISTRIBUTION
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-----052156Z 073151 /62

O 052059Z APR 77
FM SECSTATE WASHDC
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C O N F I D E N T I A L STATE 075687

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E.O. 11652: XGDS-3

TAGS: EFIN, PO

SUBJECT: CONSORTIUM LOAN FOR PORTUGAL

1. WE PLAN TO ASK THE SECRETARY TO RECOMMEND
TO THE PRESIDENT AN APPROACH ON BALANCE OF PAYMENTS
ASSISTANCE FOR PORTUGAL ALONG THE LINES OF THE FOLLOWING
PARAGRAPHS. IT DIFFERS FROM THE LINE DISCUSSED EARLIER
WITH THE GOP IN THAT IT RECOGNIZES NEW POSSIBILITIES MIGHT
PERMIT GREATER RECOURSE TO THE IMF BEGINNING LATE IN 1978,
AND IT TRIES TO ACCOMMODATE GERMAN DIFFICULTIES WITH A
THREE-YEAR CONSORTIUM. IF THIS NEW STRATEGY IS APPROVED,
IT IS EXPECTED THAT APPROACHES TO ALL POTENTIAL PARTICI-
PANTS IN SPECIAL ASSISTANCE ARRANGEMENTS TO COVER THE LAST
15-18 MONTHS WOULD BE MADE IMMEDIATELY. PLEASE CABLE ANY
COMMENTS YOU MAY HAVE "STADIS FOR EUR ONLY" BY COB
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2. SUMMARY. AFTER TWO YEARS OF ECONOMIC AND POLITICAL
DISORGANIZATION, PORTUGAL HAS UNDERTAKEN A POLITICALLY
COURAGEOUS ECONOMIC STABILIZATION PROGRAM TO RESTORE HEALTH
TO ITS SOCIETY AND RECONFIRM PORTUGAL'S PLACE IN EUROPE.
UNFORTUNATELY FOREIGN EXCHANGE SHORTAGES AND CONTINUING
DEFICITS DURING THE STABILIZATION EFFORT THREATEN PORTUGAL'S

NEW AND RELATIVELY UNTRIED DEMOCRATIC INSTITUTIONS. AT THE

REQUEST OF THE PORTUGUESE GOVERNMENT AND IN COOPERATION WITH IT, WE ARE ARRANGING A PROGRAM OF MEDIUM-TERM FINANCIAL ASSISTANCE. FINANCING WOULD CONSIST OF A CO-ORDINATED INTERNATIONAL LENDING ARRANGEMENT OF ABOUT \$750 MILLION OVER THE NEXT 15-18 MONTHS WITH PROPOSED U.S. PARTICIPATION OF UP TO 40PCT FOLLOWED BY FINANCING FROM A NEW EXPANDED IMF FACILITY IN LATE 1978 AND 1979, IF NEEDED. YOU SHOULD FORMALLY REQUEST EARLY PARTICIPATION BY YOUR HOST GOVERNMENT IN THE INTERNATIONAL LENDING ARRANGEMENT. END SUMMARY

3. BACKGROUND.

A. WHETHER THE PORTUGUESE GOVERNMENT WILL FINALLY PREVAIL OVER THE COMMUNISTS AND THE EXTREME RIGHT WILL DEPEND IN LARGE PART ON ITS ABILITY TO GET A GRIP ON AN ECONOMY BATTERED BY TWO YEARS OF REVOLUTION, LOSS OF COLONIAL MARKETS, ABSORPTION OF ABOUT 500,000 REFUGEES AND THE 1972-75 RECESSION IN THE INDUSTRIAL DEMOCRACIES. THE SOARES GOVERNMENT IS COURAGEOUSLY ADOPTING THE POLITICALLY DIFFICULT BUT NECESSARY AUSTERITY MEASURES, INCLUDING: LABOR DISCIPLINE AND PRODUCTIVITY; MEASURES TO STIMULATE INVESTMENT BY RESTORING PRIVATE SECTOR CONFIDENCE; ACTIONS TO ELIMINATE COMMUNIST DOMINANCE IN THE LABOR SECTOR AND IN AGRICULTURALLY IMPORTANT SOUTHERN PORTUGAL; INCREASED PRICES FOR GOVERNMENT SERVICES AND CUTS IN SUBSIDIES; AND PROPOSED RESTRAINTS ON WAGES TO

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HOLD INCREASES BELOW THE RATE OF INFLATION. DURING DECEMBER 27-30 THE NATIONAL ASSEMBLY APPROVED AN ECONOMIC STABILIZATION PLAN FOR 1977 AND A BUDGET DEFICIT 20 PERCENT LESS THAN IN 1976 IN REAL TERMS. ON FEBRUARY 25 THE PORTUGUESE GOVERNMENT ANNOUNCED AN ADDITIONAL PACKAGE OF ECONOMIC MEASURES, INCLUDING A 15 DEVALUATION OF THE ESCUDO AND PRICE INCREASES FOR MANY BASIC NECESSITIES.

B. HOWEVER, PORTUGAL HAS AN ACUTE FOREIGN EXCHANGE CASH SHORTAGE AND WILL LIKELY CONTINUE TO SUFFER FOR ANOTHER TWO OR THREE YEARS FROM BALANCE OF PAYMENTS DEFICITS THAT CANNOT BE COVERED BY PRIVATE TRANSFERS OR USUAL INTERNATIONAL CREDITS ALONE. WE ESTIMATE PORTUGAL WILL NEED \$500-\$800 MILLION IN BALANCE OF PAYMENTS ASSISTANCE FROM THE INDUSTRIAL DEMOCRACIES IN 1977 AND A SMALLER AMOUNT IN 1978 AND POSSIBLY EARLY 1979 AT WHICH TIME WE WOULD EXPECT THE IMF FACILITY TO BE ABLE TO MEET PORTUGAL'S NEEDS. BALANCE OF PAYMENTS ASSISTANCE IS NEEDED TO SUPPLEMENT PROJECTED COMMERCIAL AND PROJECT AID. LISBON 2002

BEING REPEATED TO YOU CONTAINS MORE DETAILS.

C. THE PORTUGUESE NEED ASSURANCE OF SUBSTANTIAL FINANCIAL ASSISTANCE WITH REPAYMENT SPREAD OVER SEVERAL YEARS. SUCH CREDITS WOULD GIVE THEM THE CONFIDENCE NECESSARY TO CARRY THROUGH THE ECONOMIC STABILIZATION AND RESTRUCTURING OF THEIR ECONOMY IN ORDER TO SUPPORT GROWTH ON A BASIS COMPATIBLE WITH THE OPEN TRADING AND PAYMENTS SYSTEM OF EUROPE AND THE INDUSTRIAL COUNTRIES GENERALLY. IN A POLITICAL SENSE, SUCCESSFUL COOPERATION OF THE INDUSTRIAL DEMOCRACIES IN SUPPORT OF DEMOCRATIC DEVELOPMENT IN PORTUGAL WILL STRENGTHEN PERCEPTIONS WORLDWIDE OF THE VITALITY OF OUR SYSTEM.

4. PROPOSED ASSISTANCE

A. THE U.S. IS PROPOSING THE FORMATION OF A COORDINATED
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INTERNATIONAL LENDING EFFORT TO ASSIST PORTUGAL IN MEETING ITS BALANCE OF PAYMENTS DIFFICULTIES OVER THE NEXT 15 TO 18 MONTHS, I.E. UNTIL PORTUGAL CAN QUALIFY FOR ENLARGED DRAWING RIGHTS FROM THE IMF.

B. WE BELIEVE THAT IMMEDIATE ACTION ON AN INTERNATIONAL BALANCE OF PAYMENTS ASSISTANCE PROGRAM IS CRITICAL FOR PORTUGUESE POLITICAL STABILITY AND ECONOMIC RECOVERY. SUCH A PROGRAM, ALREADY JUSTIFIABLE ON ECONOMIC GROUNDS, HAS ACQUIRED AN ADDED POLITICAL SYMBOLISM THAT CAN BE IGNORED ONLY AT GREAT PERIL TO PORTUGUESE DEMOCRACY.

C. FOR ITS PART, THE US IS SEEKING AN FY 1978 APPROPRIATION OF \$300 MILLION, LEAVING OPEN THE POSSIBILITY OF AN ADDITIONAL \$250 MILLION OVER THE FOLLOWING TWO YEARS IN THE EVENT OF NEED. INITIAL CONSULTATIONS WITH CONGRESS HAVE BEEN FAVORABLE AND SUGGEST THAT FUNDS WILL BE APPROPRIATED, PROVIDED REPEAT PROVIDED THAT US ASSISTANCE IS NO MORE THAN FORTY PERCENT OF A LARGER EFFORT. TO THE EXTENT THAT OTHER COUNTRIES ARE UNABLE OR UNWILLING TO MAKE ADDED ASSISTANCE AVAILABLE TO PORTUGAL, THE POSSIBLE SCALE OF US ASSISTANCE ALSO WILL DECREASE. GIVEN THE SUBSTANTIAL FINANCING REQUIRED, REPAYMENT SHOULD BE OF A MEDIUM-TERM NATURE.

D. THE U.S. THEREFORE IS SEEKING EARLY EXPRESSIONS OF SUPPORT IN PRINCIPLE FROM OTHER COUNTRIES. WE ENVISAGE THE FOLLOWING FY-1978 CONTRIBUTIONS, BASED ROUGHLY ON INDUSTRIAL COUNTRIES' RELATIVE SHARES IN THE GENERAL AGREEMENT TO BORROW (IMF QUOTAS IN THE CASE OF NON-GAB MEMBERS) AND ON ABILITY OR EXPRESSED INTEREST IN PARTICI-

PATING. ALL FIGURES IN MILLIONS OF DOLLARS.

U.S.	\$300	NETHERLANDS	25
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GERMANY	100	BELGIUM	20
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JAPAN	50	CANADA	25
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SWEDEN	25	FRANCE	10
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DENMARK	5	U.K.	5
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NORWAY	20	ITALY	5
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VENEZUELA	50	TOTAL	730
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E. WE RECOGNIZE THAT SOME PARTICIPATING COUNTRIES HAVE ALREADY MADE SUBSTANTIAL FINANCIAL CONTRIBUTIONS TO PORTUGAL AND PLAN TO MAKE ADDITIONAL DEVELOPMENTAL ASSISTANCE AVAILABLE. WHAT IS PROPOSED HERE, HOWEVER, IS SPECIAL BALANCE OF PAYMENTS ASSISTANCE ON NON-CONCESSIONAL TERMS AND SHOULD NOT REPLACE OTHER HELP BEING GIVEN BY PARTICIPATING COUNTRIES.

F. U.S. OFFICIALS WOULD BE WILLING TO ATTEND AN EARLY MEETING OF ALL INTERESTED COUNTRIES IN ORDER TO COORDINATE POSSIBLE LOAN CONDITIONS AND EXCHANGE INFORMATION ON PORTUGAL'S NEEDS AND PROPOSED LEVELS OF ASSISTANCE.

4. ACTION REQUESTED

ACTION ADDRESSEES ARE REQUESTED TO APPROACH HOST GOVERNMENT AT MINISTERIAL LEVEL AND URGE THEIR EARLY SUPPORT AND AGREEMENT TO SEND A REPRESENTATIVE TO AN EARLY MEETING OF PARTICIPANTS. YOU SHOULD MAKE APPROACH AFTER COORDINATING WITH YOUR PORTUGUESE COLLEAGUE WHO HAS RECEIVED PARALLEL INSTRUCTIONS. YOU SHOULD MAKE USE OF THE INFORMATION IN PARAS 2 AND 3. YOU MAY DRAW ON THE ATTACHED ILLUSTRATIVE TABLE (PARA D ABOVE) IN SUGGESTING A POSSIBLE LEVEL OF CONTRIBUTION FROM YOUR HOST GOVERNMENT (BUT DO NOT RELEASE FIGURES FOR OTHER COUNTRIES). CONTRIBUTIONS

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ARE LARGELY BASED ON PERCENTAGE SHARE OF GAB. SOME

COUNTRIES, HOWEVER, SUCH AS THE U.S., NORWAY AND VENEZUELA ARE BEING ASKED TO EXCEED THEIR GAB SHARE SINCE THESE COUNTRIES HAVE SUBSTANTIALLY MORE RESOURCES.

5. FOR LONDON. YOU SHOULD ALSO INFORMED THE BRITISH IN THEIR EC PRESIDENCY CAPACITY, THAT WE PLACE PARTICULAR IMPORTANCE ON EC 9 CONTRIBUTION TO THE INTERNATIONAL

LENDING ARRANGEMENT GIVEN THE STAKE BOTH WE AND THE EC HAVE IN THE FUTURE OF PORTUGUESE DEMOCRACY. WHILE WE RECOGNIZE THAT EXISTING EC MECHANISMS DO NOT LEND THEMSELVES TO COMMUNITY BALANCE OF PAYMENTS ASSISTANCE TO PORTUGAL, WE HOPE THE NINE WILL GIVE THE LENDING ARRANGEMENT THEIR FULL BACKING.

6. FOR USEC. YOU SHOULD INFORM THE COMMISSION OF U.S. APPROACHES TO THE MEMBER STATES AND THE PRESIDENCY, EXPRESSING OUR HOPE THAT THE COMMISSION WILL SUPPORT THE LENDING ARRANGEMENT.

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: CONSORTIUMS, LOANS, BALANCE OF PAYMENTS, INTERGOVERNMENTAL COOPERATION
Control Number: n/a
Copy: SINGLE
Sent Date: 05-Apr-1977 12:00:00 am
Decaption Date: 22 May 2009
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977STATE075687
Document Source: CORE
Document Unique ID: 00
Drafter: WE/EMROWELL
Enclosure: n/a
Executive Order: X3
Errors: N/A
Expiration:
Film Number: D770118-0986
Format: TEL
From: STATE
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770485/aaaacwpix.tel
Line Count: 244
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: d80defa9-c288-dd11-92da-001cc4696bcc
Office: ORIGIN EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: ONLY
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: ONLY
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 02-Dec-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2890590
Secure: OPEN
Status: NATIVE
Subject: CONSORTIUM LOAN FOR PORTUGAL
TAGS: EFIN, PO
To: LISBON
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/d80defa9-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009